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BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

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November 17, 2000

Via HAND DELIVERY

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423

RE: **STB Ex Parte No. 582 (Sub-No. 1)**

Dear Secretary Williams:

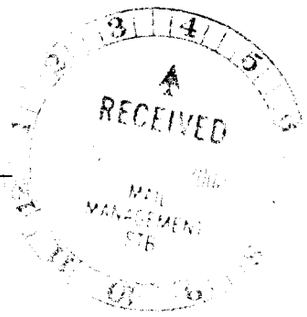
Enclosed for filing in the captioned proceeding are an original and 25 copies of the Comments of the Association of American Railroads. Also enclosed is a diskette containing the Comments in WordPerfect 6.0.

Thank you for your attention to this matter.

Sincerely,

Samuel M. Sipe, Jr.
Counsel for the Association of
American Railroads

Enclosures



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EX PARTE NO. 582 (Sub-No. 1)

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COMMENTS OF
THE ASSOCIATION OF AMERICAN RAILROADS

The Association of American Railroads ("AAR") submits these comments in response to the Board's October 3, 2000 Notice of Proposed Rulemaking in the above-captioned proceeding ("NOPR").[1] AAR represents the interests of the nation's major freight railroads. Its members operate 76 percent of the rail route miles in the United States, employ 90 percent of rail employees and generate 93 percent of U.S. rail freight revenues. AAR previously submitted comments on May 16, 2000 in response to the Board's March 31, 2000 Advance Notice of Proposed Rulemaking in this proceeding.

I. Introduction and Overview

The Board states that its proposed revisions to the rail merger policy "represent a paradigm shift in our review of major mergers." NOPR at 10. AAR has significant concerns about a central aspect of the policy shift proposed by the Board which would emphasize the creation of governmentally mandated, non-remedial competition as a preeminent public benefit in rail mergers. That policy shift would be a stark departure from the existing requirement of statute and case law that the Board address adverse effects on competition. AAR believes that

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[1] The Canadian National Railway Company is not a participant in these Comments.

market-based competitive rivalry is in the public interest. But it is one thing for the Board to encourage market-based, private sector initiatives that result in more vigorous competition and to recognize such initiatives as public benefits. It is quite another thing for the Board to use its merger review authority to restructure railroad markets by mandating conditions that are unrelated to any harms caused by a proposed merger.

Rail mergers have been driven in the post-Staggers era by the market-based imperative that the merging carriers become more effective competitors. Recent mergers have been particularly driven by the carriers' need to compete more effectively with other transportation modes, especially trucks, and the Board has recognized that the public interest is served by the enhanced intermodal competition that results. Most recent mergers have also included significant non-mandated enhancements in rail-to-rail competition. In the merger context, as elsewhere, enhanced competition should continue to flow from voluntary, market-based initiatives, not from government mandates.

AAR urges the Board to modify its proposed new policy to provide that it will recognize as a public benefit enhanced competition that flows from the voluntary initiatives of merger applicants but will not impose conditions unrelated to the effects of a merger as a prerequisite for merger approval. The latter requirement is both onerous and unwise. It would treat railroads more harshly than any other U.S. industry and jeopardize the very public interest that the Board is charged with protecting.

Moreover, the proposed rules would not serve the public interest in prompt and efficient resolution of merger cases. The Board's proposal would complicate and delay merger review proceedings that are already cumbersome. The possibility of Board-imposed non-remedial conditions would be an invitation for expanded litigation in merger proceedings over conditions

having nothing to do with anticompetitive effects of a merger, with attendant delay. The Board should be looking for ways to expedite the merger review process instead of further complicating it.

The governing statute requires that the Board consider whether a proposed transaction would have an adverse effect on competition and it authorizes the Board to impose conditions to remedy any adverse effects of a merger. The proposed rules would fundamentally change the Board's role, giving it the power to restructure railroad markets as the price for merger approval in ways the Board, not the market participants, deems appropriate. The Board should remain vigilant in ensuring that mergers do not reduce competition, but it should not assume the role of industrial planner in the merger process.

Particularly disturbing is the suggestion that merger applicants will be forced to implement competitive "fixes" that are not designed to remedy specific competitive harms. This suggestion portends a departure both from reliance on market forces and from the logic of cause and effect remediation that has guided the Board and its predecessor in prior merger cases. If the Board requires merger applicants to make structural changes that the companies would not otherwise implement and that are not intended to remedy specific competitive harms, the Board is engaged in industrial planning, not in promoting competition.

The Board attempts to justify its mandate of non-remedial competition by relying on a series of presumptions: (1) the presumption of unremediable harm, (2) the presumption that permanent non-remedial competitive conditions will be necessary to offset transitory merger-related service disruptions, and (3) the presumption of no significant merger efficiencies. As we explain in more detail below, these presumptions are unwarranted.

The Board's reliance on mandated, non-remedial competition as a linchpin of its new rail merger policy has three potentially dangerous implications for the rail sector of the economy. First, it means that a proposed rail merger that would yield substantial net public benefits (and no unremedied competitive harms) might not be undertaken because the applicants would be required to sacrifice too large a share of private benefits through compliance with the new competitive conditions. The revenues lost through contrived restructuring of rail-to-rail competition could readily exceed a merger's expected cost savings. Under these circumstances, the potential merger partners could not justify such a transaction even if it promised unequivocal benefits for shippers such as improved service and access to new markets.

Second, the Board's focus on mandatory restructuring of rail markets would introduce an unacceptable level of uncertainty into the merger review process. Since the mandated competitive conditions would, by definition, be unrelated to the effects of the merger, the applicants would have no way of knowing in advance what would be sufficient to pass Board muster. The Board's merger rules should be sufficiently clear to give potential merger applicants and other interested parties guidance as to what showings will be required to satisfy the public interest standard. Lack of certainty could adversely affect carriers' efforts to arrange financing for transactions that are in the public interest.

Third, increased reliance on regulatory mandates to restructure competition in the rail merger context would correctly be perceived as a step toward increased economic regulation of the industry. If merger applicants are required to propose new competitive conditions unrelated to any harms created by the merger and the Board retains the authority to monitor and enforce the implementation of those conditions, the Board will have expanded vastly its role in the structuring of rail markets. Any movement toward regulatory interference in rail markets would

further imperil the rail industry's financial health, potentially leading to reductions in the size and scope of the railroad network to the detriment of the public.

The benefits of market-based regulation brought about by the Staggers Act are well known to the Board. While protecting the interests of captive shippers, the current regulatory regime gives railroads the flexibility to price service in response to demand, to offer new services that shippers value and to configure the rail network to achieve efficiencies. The result has been dramatic improvements in rail productivity, increases in infrastructure investments and lower prices. AAR described these developments in detail in its May 16, 2000 Comments on the Board's Advance Notice of Proposed Rulemaking in this proceeding.

The Board may believe that the objectives of the Staggers Act have now largely been achieved, and that it is no longer as important to pursue the market-based regulatory policies that proved successful after 1980. Such a belief would be unfounded. The freight railroads face difficult challenges. Notwithstanding improvements in financial performance, freight railroads still have not attained adequate revenue levels, and they remain in an inferior position relative to other U.S. businesses with which they must compete to raise capital.[2] It would be unwise for the Board to embrace a more activist regulatory role at a time when continued market-based innovation is needed.

If there are any future rail mergers – and that prospect would certainly be less likely under the Board's proposed rules – it would only be because the applicants would be driven by the same market-based impulse to compete more effectively that brought about recent mergers.

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[2] In this regard, it is ironic, indeed, that the Board's proposed merger rules would impose a requirement of non-remedial competition that is entirely foreign to the antitrust laws which govern mergers in other industries.

The Board will best discharge its responsibilities under the statutory public interest standard by giving weight to the public benefits of enhanced competition when they emerge from market-based proposals. There is no need and no legitimate place for a standard of governmentally mandated, non-remedial competition in the rail merger process.

* * *

AAR's comments below focus on the Board's treatment of the competitive effects of mergers, which is an aspect of the proposed rules that is of grave concern to its members. AAR also addresses several other aspects of the Board's proposed rules. The proposed rules are also addressed in the individual comments of AAR's members.

II. The Board's Approach to Restructuring Rail Competition

The Board's proposed change in policy regarding mandatory conditions unrelated to the effects of a merger would represent an unfortunate shift away from reliance on market forces, which was the defining character of Staggers Act regulatory reforms, to a much greater emphasis on regulatory judgment and intervention. Any such shift in focus regarding rail competition would be of grave concern to AAR.

According to the Board, the proposed revision to the general merger policy statement "adds and highlights enhanced competition as an important public interest benefit." NOPR at 11. AAR agrees that enhanced competition resulting from the voluntary undertakings of merger applicants should be recognized as a public benefit by the Board in determining whether a transaction is in the public interest. Mergers in this and other industries are often driven by a desire to form a stronger firm that can compete more effectively, and those mergers ultimately can bring significant public benefits. For this reason, antitrust law and antitrust enforcement

agencies do not artificially discourage mergers, but instead seek only to protect against anticompetitive effects.

AAR endorses the suggestion in the proposed policy statement that "[t]he Board welcomes private sector initiatives that enhance the capabilities and competitiveness of this transportation infrastructure." Proposed § 1180.1(a). Applicants can appropriately be encouraged to pursue such initiatives and should be given credit for structuring transactions that portend such public benefits.

The Board's proposed rules go much farther, however, and would require merger applicants to propose structural changes that are not driven by the market and that are not intended to remedy any competitive harm. AAR takes issue in particular with the following statement from Proposed § 1180.1(c): Public interest considerations:

> To maintain a balance in favor of the public interest, merger applications must include provisions for enhanced competition. Unless merger applications are so framed, approval of proposed combinations . . . will likely cause the Board to make broad use of the powers available to it . . . to condition its approval to preserve and enhance competition.

The proposed rules expressly provide that "applicants will be required to propose conditions that will not simply preserve but also enhance competition." NOPR at 16 (§1180.1(d)).

As discussed below, the foregoing approach to competition would be inconsistent with the controlling statute and contrary to sound public policy.

A. The Presumptions About Competitive Effects and Efficiencies of Future Mergers Should Be Replaced with Case-by-Case Analysis

The Board's proposed policy shift is based on three presumptions about the effects of future mergers that are unfounded and inappropriate. First, the Board presumes that future mergers will bring about anticompetitive effects that are unremediable, thus requiring a contrived

restructuring of the market to offset the adverse effects. Second, the Board assumes that mandatory, non-remedial conditions are necessary to offset temporary service disruptions resulting from the merger's implementation. Finally, the Board presumes that future mergers will not yield appreciable efficiency gains that might offset any unremedied adverse effects on competition.

Sound administrative decisionmaking should be based on a careful review of evidence in the record. Presumptions should be used only when a solid factual record has been created that supports the inferred facts without the need for any additional factual development.[3] Such a factual record does not exist in this proceeding. The Board cannot carry out its statutory mandate to determine whether a particular merger is in the public interest by substituting presumptions for a thorough review of the facts raised by each transaction. The Board should examine each merger on a case-by-case basis to determine whether any adverse effects on competition are likely and confine itself to addressing those effects. If the adverse effects of a merger cannot be remedied or are not offset by anticipated benefits, then the merger should not be approved.

1. The Presumption That Anticompetitive Effects of Future Mergers Will Be Unremediable

The Board's focus on restructuring rail markets stems in large part from its conclusion that future rail mergers would have anticompetitive effects that would not be directly remediable. According to the Board, future mergers are "likely to result in a number of anticompetitive

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[3] *See NLRB v. Baptist Hosp. Inc.*, 442 U.S. 773, 787 (1979) ("It is, of course, settled law that a presumption adopted and applied by the Board must rest on a sound factual connection between the proved and inferred facts").

effects, such as loss of geographic competition, that are increasingly difficult to remedy directly or indirectly." NOPR at 12 (§1180.1(c)). The origins of this presumption are unexplained. There is no tangible evidence in the record of this rulemaking to support a presumption that any anticompetitive effects of future mergers cannot be remedied through conditions narrowly tailored to address the particular competitive harm.

The limited analysis offered in support of this first presumption is unpersuasive. The Board observes that shippers "served by a single rail carrier nevertheless benefit from having another carrier nearby." NOPR at 13. According to the Board, the problem with future mergers is that "as the number of independent railroads decreases, . . . the next available option moves farther away," eliminating the beneficial effects of having another rail carrier in close proximity. *Id.* While this could be a valid concern in some circumstances, it is unreasonable to presume that this effect will be produced in all future mergers. For example, a merger that is predominantly end-to-end might not have any effect on the proximity of a shipper's next available option. Whether or not this competitive harm arises in a particular merger needs to be addressed when the merger is presented, not presumed in advance.

The Board also states that future rail mergers will result in reductions of geographic competition that cannot be remedied by the kinds of voluntary fixes and Board-imposed conditions that have been applied to reductions in intramodal competition. There is no reason to believe that appropriate competitive conditions will not be available to remedy specific losses of geographic competition. If a merger were to eliminate an effective transportation alternative, whether that alternative falls into the category of geographic, product or intramodal competition, the same types of conditions used to remedy losses of intramodal competition should be able to

restore the competitive status quo. The loss of geographic competition, like the loss of any other type of competition, should be demonstrated on the record and not presumed.

If the merger applicants do not offer adequate remedies for any loss of competition that is demonstrated on the record, the Board has ample authority to fashion appropriate remedies. As discussed later in these comments, the statute gives the Board authority to impose conditions to remedy specific harms and the Board and its predecessor have used that authority frequently in the past. In fact, ever since the ICC declined to approve the *SF/SP* merger in the mid-1980s, merger applicants themselves have worked hard to identify possible competitive harms and to fashion appropriate remedies before filing their application for agency approval.

Merger applicants should be given the opportunity to prove that any merger-related harms can be remedied or that any unremedied losses are offset by competitive benefits such as increases in intermodal competition. In that connection, AAR is troubled that the Board, while recognizing that railroads are part of a broader national rail transportation system, has not acknowledged the significant impact of increased competition between railroads and trucks on the public interest. The fact is that future rail mergers with strong vertical elements could significantly enhance competition with other transportation modes. A railroad offering more extensive or more efficient single-line service is likely to be a stronger competitor not only with trucks but also with barges and coastal vessels. Similarly, the Board's proposed rules do not acknowledge the possibility of substantial procompetitive network effects created by the new merged railroad, such as expanded access by shippers to downstream markets.[4]

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[4] *See, eg., Union Pacific Corporation et al. -- Control -- Chicago and North Western (UP/CNW)*, slip op. at 71 (served Mar. 7, 1995) (discussing expanded market opportunities for grain shippers); *Burlington Northern Inc., et al. -- Control and Merger -- Santa Fe Corporation, et al. (BN/SF)*, slip op. at 59-61 (served Aug. 23, 1995) (discussing expanded domestic and

(Continued ...)

In short, the Board should not presume that there would be a net loss in competition stemming from future rail mergers but should leave that issue to a case-by-case determination. If the record shows that a merger would create a net loss in competition, applicants should be charged with a strategy for remedying that loss that is related as directly as possible to the loss. If the applicants do not propose effective remedies for specific harms, then it would be appropriate for the Board to consider remedies addressed to those harms as well as any proposals by applicants for structural changes that would offset otherwise unremediated harms. The Board should not require as a threshold matter that all applicants submit contrived competitive proposals based on a presumption of unremediable competitive harm.

2. The Presumption That Competitive Conditions Are Necessary to Address Merger-Related Service Disruptions

The second rationale for the proposed requirement of non-remedial competitive conditions is the Board's presumption that the benefits of such competition will be needed to offset the likely harms from transitional service disruptions. As the Board explains, "[b]ecause of the increased likelihood of transitional service problems and the difficulty of crafting appropriate conditions to mitigate competitive harm, our proposed rule requires applicants to provide a plan for enhancing competition." NOPR at 13. See also Proposed §1180(d) ("applicants will be required to propose conditions that will not only preserve but also enhance competition" in order to offset harms including "transitional service disruptions").

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international market opportunities); *Union Pacific Corporation, et al. -- Control and Merger -- Southern Pacific Rail Corporation, et al. (UP/SP)*, slip op. at 262-66 (served Aug. 12, 1996) (same).

AAR believes that greater emphasis should be placed on service planning in future merger proceedings to ensure that service disruptions do not occur, and it supports the Board's proposal to require service assurance plans to reduce the chance that service disruptions of the type seen in some recent mergers will recur. AAR notes that while there have been significant service disruptions in the wake of the UP/SP merger and the Conrail transaction, those combinations had unique attributes that were at the heart of the service problems. In the UP/SP merger, the UP acquired a railroad with inadequate and deteriorating infrastructure. In the CSX/NS/Conrail transaction, CSX and NS were carving up an existing railroad. The Board should not presume that these conditions will exist in future mergers.

Even if the Board were to conclude that the increased focus on service and operating issues in future merger proceedings will not eliminate the risk of service disruptions, it would be unreasonable to require merger applicants to implement *permanent* structural changes to address or compensate for possible *temporary* service disruptions. In the Board's recent rulemaking on service emergencies, the Board itself acknowledged that the duration of service-related remedies should be linked to the duration of the problems. For this reason, the Board established a three-tiered set of service-related remedies to address service problems of different durations. For short-term emergency relief, the Board adopted expedited rules under 49 C.F.R. Part 1146 that were subject to a 270 day maximum duration. The Board adopted a separate set of rules in 49 C.F.R. Part 1147 applicable "to requests for temporary alternative service under [49 U.S.C.] sections 10705 or 11102, on a more developed record, to address serious (but not necessarily emergency) service problems."[5] The remedies in this section of the rules were not subject to the

[5] *Expedited Relief for Service Inadequacies*, STB Ex Parte No. 628, slip op. at 6 (served Dec. 21, 1998).

same strict time limitations as the Part 1146 rules, because they were intended to address problems of a potentially longer term, although still temporary. Finally, the Board reiterated that its competitive access rules "remain available for more permanent alternative service . . . to address competitive abuses."[6] In other words, the Board recognized that permanent structural changes were not appropriate as a remedy for temporary service problems.

A requirement that merger applicants implement structural changes in rail-to-rail competition would also be counterproductive if the mandatory competitive conditions have the effect of compounding service disruptions. For example, if service problems were to result from congestion on the new merged carrier's lines, expanded access by other railroads to those lines or expanded reciprocal switching obligations could, under some circumstances, compound the congestion. Coordinating the movement of trains operated by another railroad on the congested lines might delay resolution of the service problem. Temporary access conditions can be an effective means of alleviating service problems if they are tailored to the specific circumstances of the service failure. But if merger applicants are required to adopt structural changes unrelated to potential service problems and before any service problems have arisen, the impact of those structural changes is impossible to assess. They could exacerbate the harms they are intended to offset.

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[6] *Id.*

3. The Presumption That Future Mergers Will Not Yield Efficiency Gains

The Board's presumption that future rail mergers will not yield significant efficiency gains is another rationale for mandated, non-remedial competition. This presumption is also unfounded.

The Board is correct that many past mergers have yielded efficiency gains stemming from the elimination of duplicative or unproductive infrastructure. But those are not the only efficiency gains that mergers can produce. Mergers offer potential efficiencies in the form of cost savings or network improvements that can be passed on to shippers through lower rates, improved service and expanded service offerings.[7] The expanded availability of efficient single-line service can open new markets for shippers. A larger network of shippers and receivers can create new business opportunities for rail users. Importantly, such efficiency gains are strong drivers of enhanced competition, particularly enhanced competition between railroads and trucks.[8]

AAR does not ask the Board to presume that such efficiencies would necessarily flow from future mergers, but, by the same token, the Board should not presume that they would not occur. Instead, the rules should call upon applicants to make convincing demonstrations of any efficiencies that will flow from future combinations. The Board should make clear that it will

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[7] *See, e.g., Canadian National Railway Co., et al. -- Control -- Illinois Central Corp. (CN/IC)*, slip op. at 19-20, 22 (served May 25, 1999).

[8] *See, e.g.*, BN/SF at 61 (discussing enhanced competition with trucks resulting from vertical efficiency gains); *CSX Corp., et al. -- Control and Operating Leases/Agreements -- Conrail Inc., et. al. (CSX/NS/Conrail)* slip op. at 51 (served July 20, 1998) ("the transaction will permit both CSX and NS to compete more effectively with motor carrier service").

recognize such efficiency gains, including any enhanced intermodal competition that they generate, as public benefits.

B. The Statutory Public Interest Standard that Governs the Board's Oversight of Rail Mergers Does Not Entail the Concept of Mandatory, Non-Remedial Competition that the Board Proposes To Engraft Upon Its Merger Policy

The statute governing the Board's review of rail mergers specifically instructs the Board to consider "whether the proposed transaction would have an adverse effect on competition among rail carriers in the affected region or in the national rail system."[9] The Board may approve a merger only if "the transaction is consistent with the public interest."[10] And if the Board finds that a merger would adversely affect competition, "the Board may impose conditions governing the transaction, including divestiture of parallel tracks or requiring the granting of trackage rights and access to other facilities."[11]

The Board and the ICC before it have used this authority to address a broad range of competitive harms in past mergers and to preserve competition that previously existed. Among the more common and effective means of preserving competition where a shipper's options have been reduced have been the granting of trackage and haulage rights[12] and interchange rights.[13]

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[9] 49 U.S.C. § 11324(b)(5).

[10] 49 U.S.C § 11324(c).

[11] *Id.*

[12] *See, e.g., Union Pacific Corporation et al. -Control - Missouri Pacific (UP/MP/WP)*, 366 I.C.C. 459; 566-72 (1982).

[13] *See, e.g., Union Pacific Corporation, et al. -- Control -- Missouri-Kansas-Texas Railroad Company, et al. (UP/MKT)*, 4 I.C.C.2d 409, 466, 471 (1988).

Other approaches, tailored to the specific circumstances of the proposed merger, have proven effective.[14]

The Board's authority to address adverse effects of proposed mergers is sufficiently broad that the merger applicants generally try even before filing the application to identify areas where competitive problems are likely to arise and to propose solutions to those problems. Competitive issues that are not anticipated before filing are often the subject of extensive negotiation while the merger application is pending. These negotiations often lead to structural changes beyond those needed to remedy specific harms, although they are reached voluntarily and not mandated by the Board. In *BN/SF*, for example, the applicants voluntarily entered into a number of settlement agreements that the ICC found went "far beyond what is required to ameliorate the anticompetitive impacts of the merger."[15]

In contrast to such voluntary measures, the Board's suggestion that it will *require* competitive conditions beyond those needed to address competitive harms would be inconsistent with the existing statutory scheme and potentially damaging to the public interest. In the *UP/MP/WP* merger, the ICC articulated the standard that governs the agency's conditioning authority: "The basic consideration for determining whether a need for a public interest condition exists is whether the transaction will have anticompetitive consequences (or threaten other possible harm to the public interest). If a transaction does not pose any problems of

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[14] Board imposed conditions have included, among other things, terminal access (*e.g.*, *UP/MKT* at 482-83), modification of joint facilities agreements (*e.g.*, *UP/CNW* at 89-90), and preservation of build-out options (e.g., *BN/SF* at 98).

[15] *BN/SF* at 83.

possible harm to the public interest, then no public interest conditions should be imposed."[16] The Board and the ICC have repeatedly found that their conditioning authority does not and should not go beyond the correction of competitive harms created by the merger.

The principal risk in imposing additional conditions on a transaction that would otherwise offer net public benefits is that the costs of the new conditions may lead the merger proponents to abandon the transaction, eliminating the public benefits that the merger would have created. As the ICC stated: "imposition of conditions not related to possible adverse impacts of a consolidation might cause carriers to forego a consolidation that would, without conditions, yield net public benefits."[17] The fact that the proposed rules would require merger applicants to propose the additional conditions in the first instance does not reduce this risk. If the Board has made it clear that competitive restructuring will be required, and if the merger applicants determine that the cost of such restructuring will be too high, they will simply forgo filing the application.

The uncertainty inherent in the Board's proposed requirement for non-remedial competition heightens the risk that railroads will forego mergers that are in the public interest. The rail community – railroads, shippers, and investors – need certainty in rules governing transactions as large, time-consuming and complex as mergers. A requirement that merger applicants adopt competitive conditions that have no relationship to the effects of the merger leaves the rail community with insufficient guidance as to what will be required to obtain Board approval of a transaction. The nature or extent of the required non-remedial competition cannot

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[16] *UP/MP/WP*, 366 I.C.C. at 563.

[17] *Id.* at 564.

be determined in advance because there is nothing against which to measure it – by definition, the required conditions are not intended to offset or remedy specific or identifiable harms. The inability to predict with any certainty the Board's position could discourage future mergers that would advance the public interest.

The public benefits of a merger might also be compromised by the unpredictable effects of conditions that are implemented by the merger participants only under compulsion by the Board and unrelated to the effects of the merger itself. In the SF/SP proposed merger, the ICC rejected certain competitive conditions sought by shippers that were not directly related to the competitive harms created by the merger specifically because those proposed conditions would "broadly restructure the competitive balance among railroads with unpredictable effects."[18] The Board's apparent intent to monitor the implementation of the proposed non-remedial conditions would compound this uncertainty and unpredictability.

The existing statute contemplates that the competitive structure of the rail system will be driven by the judgment of market participants and not by regulators charged with applying the public interest standard. The ICC and the Board have maintained a consistent position on this question of statutory interpretation since the Staggers Act. As the ICC explained in the *UP/MP/WP* merger decision:

> [W]e should not use our conditioning powers to make consolidation proceedings vehicles for rail system restructuring. To do so would not be consistent with the Congressional intent underlying the statutory scheme governing railroad consolidations. . . . [S]ince 1940 rail system restructuring has been left primarily to the initiative of the private sector. Under this statutory scheme,

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[18] *Santa Fe Southern Pacific Corp. -- Control -- Southern Pacific Transportation Company, (SF/SP)*, 2 I.C.C.2d 709, 827 (1986) (emphasis added).

> our role in merger proceedings is to evaluate *carrier-originated* proposals to determine whether they are consistent with the public interest.[19]

Elsewhere, the ICC has "properly rejected the notion that the Staggers Act is a mandate for [the Commission] to compel restructuring of the rail industry to create more rail-to-rail competition."[20]

The merger statute contemplates a balancing test: If the merger-related benefits outweigh merger-related harms, then the Board should approve the transaction. Conversely, if future mergers create competitive harms that are difficult to remedy through narrowly tailored conditions, and if there are no other public benefits that outweigh these competitive harms, then the merger proponents will necessarily have to come up with fixes or other measures that will tip the public interest balance in favor of the merger. The statute provides the Board with adequate means to ensure that future mergers are consistent with the public interest, and it limits the Board to this function. The Board has no need and is not authorized to engage in industrial planning to carry out the role contemplated for it by Congress.

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[19] *UP/MP/WP*, 366 I.C.C. at 564.

[20] *Intramodal Rail Competition - Proportional Rates*, Ex Parte No. 445 (Sub-No. 2), slip op. at 4 (served April. 17, 1990).

III. Comments on Other Aspects of the Proposed Rules

A. Market Impact Analyses

The Board proposes detailed rules in §1180.7 prescribing the market analyses that must be submitted in support of a merger application and the data that must be included in those analyses. AAR understands the Board's desire to have detailed information about the markets likely to be affected by a merger, and it generally agrees that it would be appropriate for merger applicants to address the matters described in proposed §1180.7. The Board should recognize, however, that reliable data about some aspects of transportation markets simply do not exist, particularly as to non-rail traffic. Therefore, AAR suggests that the Board add at the end of proposed §1180.7(b), just before paragraph (1), the following: "Applicants' impact analyses must at least provide the following types of information *to the extent reliable data exist*."

In addition, the Board should be flexible as to the types of market analyses that it will require of the merging parties. It would be inappropriate and counterproductive to impose rigid or inflexible format or data requirements on the merger parties since that approach could impose unnecessary burdens on the merger applicants and result in studies that do not address the market and competition issues likely to be most relevant to a particular transaction. Circumstances will differ from case to case and the applicants need to have flexibility in presenting relevant information in a way that best allows the Board to evaluate the market impact of a proposed transaction.

B. Service Assurance Plans

AAR supports the need for service assurance plans but it is concerned that the Board assumes that the railroads have a greater control over future events than is actually the case. The Board should therefore clarify that, in evaluating the adequacy of these plans and in monitoring

their implementation, it acknowledges that railroads have limited ability to predict and control future events. Proposed §1180.10 states that the plans should describe "with *reasonable precision* how operating plan efficiencies will translate into present and future benefits for the shipping public." The Board should clarify that the degree of precision it will expect in the service assurance plans will be evaluated in light of the inherent uncertainty about future conditions in railroad markets.

The Board should also make it clear that while it expects reasonable precision in the service assurance plans based on conditions that can be anticipated at the time of the merger application, it does not intend to lock the merged carrier into the operations described in those plans. If a newly merged carrier is to operate efficiently, it needs to have the flexibility to respond to future changes in demand and operating conditions. Detailed service plans are therefore appropriate to evaluate conditions that are foreseeable at the time of the merger application, but they would be counterproductive if used as a script for future railroad operations.

AAR also believes it is important that the Board not allow its preference for privately negotiated agreements to confer undue bargaining power on non-applicant parties to merger proceedings. AAR is particularly concerned about the Board's statement that the "extent to which applicants are successful in such negotiations would be an important consideration in our determination as part of the balancing process of the likelihood of merger-related service harm and the possible need for mitigation." NOPR at 20. This statement could be read by shippers and connecting carriers as implying that applicants will be penalized if they are unable to reach negotiated agreements on service assurances. It would be inappropriate and counterproductive

for the Board to "alter[] the relative bargaining position of the parties" in such a way.[21] If the shippers and connecting carriers believe that the merger applicants will be penalized if no agreement is reached, they will be encouraged to make demands beyond those they actually need and to refuse to make reasonable compromises that might lead to negotiated agreements. It would actually become more difficult to reach an agreement on service assurances if one side believed it would improve its position by holding out as long as possible and threatening to force the issue by going to the Board without an agreement.

Finally, AAR suggests a technical change to the rule governing the content of the service assurance plan. In proposed §1180.10(a), the Board proposes that the applicants should use "benchmarks for the year immediately preceding the filing date of the application" as the basis for their plans. Depending on the date the application is filed, data for the immediately preceding year may not be available. The rule should state that the applicants may use data from the most recent 12 month period for which data are available.

Individual AAR members will comment further about the level of detail required in the proposed rules.

C. Cumulative Impacts and Crossover Effects

AAR is concerned that the Board's treatment of cumulative and crossover effects places too much weight on speculation. Merger applicants may address possible future scenarios in general terms so that the Board can evaluate the likely impact of a proposed merger on railroad markets. But the Board cannot expect merger applicants to quantify the public benefits of a proposed merger "in light of anticipated downstream effects" with precision. See NOPR at 20

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[21] *Brae v. ICC*, 740 F.2d 1023, 1055 (D.C. Cir. 1984).

(§1180.1(i)). AAR is concerned that the Board will expect an unrealistic level of detail in the merger applicants' supporting materials.

There are several difficulties in predicting downstream or crossover effects with precision. Even if the merger applicants correctly anticipate which other firms will seek to combine, they cannot know how the proposed combination will be structured, where the downstream merging firms will redirect traffic, what efficiencies the downstream merger will hope to achieve, or any number of other characteristics of the downstream transaction that would be critical to any quantitative analysis. Nor can the merger applicants anticipate the types of competitive conditions the downstream applicants will propose or the conditions that might be required of them. It is one thing to describe the possible contours of future mergers and discuss the possible effects on the market, but it is quite another to expect a quantitative analysis of public benefits in light of future transactions. Such a requirement virtually invites public policy decisions based on speculation.

The STB's proposal that the merging parties identify new conditions that might be required as the result of future mergers is particularly inappropriate. First, it is uncertain what kind of a showing the merger applicants are expected to make. If the requirement to establish non-remedial conditions at the time of the merger lacks meaningful definition, a requirement to establish such conditions in the future in light of unknown future events is even more uncertain.

In addition, given the broad range of variables that would have to be anticipated to propose future conditions related to future mergers, such "springing conditions" proposed by the merger applicants could well be inapplicable or irrelevant to the precise concerns raised by future transactions. Conditions that are not tailored to particular harms risk creating harms of their own. Given the uncertainty in predicting the character of future transactions and the dynamics of

future markets, the chance that the merger applicants' proposed conditions would be appropriate is quite small. It is not sound policy to require merger applicants to propose contingent conditions based on speculation about the future.

D. Class II and Class III Railroads

Various aspects of the proposed rules call upon applicant carriers to assess the impact of a proposed transaction on short line and regional railroads. AAR recognizes the vital role of Class II and Class III railroads in creating and maintaining a strong national rail transportation system. Over 500 regional and short line railroads account for approximately 9 percent of total annual railroad revenues in the United States and it is estimated that 16 percent of all U.S. carload originations start on regional and short line railroads. Because the Class I railroads and the regional and short-line railroads are partners in meeting the public's shipping needs, AAR has actively sought in recent years to address the concerns of the Class II and Class III railroads. In 1998, these efforts resulted in a comprehensive Rail Industry Agreement between AAR and ASLRRA which addressed contractual interchange commitments (so-called "paper barriers"), car supply, heavy axle loads, routing alternatives, and other matters of concern to the railroads.

Since then, the AAR has worked extensively with the regional and short-line railroads to implement the agreement and to ensure that its benefits and goals are realized. Most recently, an Implementation Group was established to facilitate communication among those affected by the RIA and to promote a common interpretation and understanding of it. The group consists of representatives of the Class I railroads and the short line and regional railroads. In addition, a special mediation review process was established for short line railroads that believe they have been adversely affected by an action of a Class I railroad in a manner that is inconsistent with the terms of the RIA. The AAR and the ASLRRA would act as facilitators between the two parties

to ensure that the issues involved and the rights and obligations of the parties to the RIA were properly framed and understood.

AAR has also been active in looking for a solution to the problem of infrastructure disparity between Class I railroads and some Class II and Class III railroads. The RIA recognizes the need to upgrade rail infrastructure to handle 286,000 pound cars, and it provides for a sharing of increased revenues attributable to heavy axle loads. In addition, the Class I railroads have supported legislation to provide federal funds to the regional and short line railroads for upgrading their trackage to handle the heavier cars.

AAR's members remain committed to the spirit of cooperation and partnership that underlies the RIA, and for this reason it supports the Board's proposal that the interests of Class II and Class III railroads be addressed in the merger application process. Applicants should address anticipated effects of a proposed merger on regional and short-line railroads, should identify benefits that those railroads and their customers will realize as a result of the transaction, and should develop remedies for any anticipated harms to the public interest by virtue of a merger's impacts on regional and short-line railroads.

E. Environment and Safety

The Board proposes a new rule addressing merger-related environmental issues which "encourages negotiated agreements" to resolve environmental and safety issues. Proposed §1180.1(f)(1). AAR favors negotiated resolution of environmental issues to the widest extent possible, and it therefore supports the Board's proposal. On a technical point, AAR suggests that the Board modify its reference to negotiated agreements with "groups of neighborhood communities" since it is doubtful that such groups could legally enter into agreements. Instead,

the Board should encourage negotiated solutions with recognized governmental or public entities.

With the Board's increased emphasis on negotiated solutions, AAR believes it would be appropriate for the Board to clarify that it will only consider environmental and safety issues that arise from the proposed merger and that it will not address preexisting conditions or reasonably foreseeable uses of railroad facilities. The Board has recognized that it is inappropriate to use the occasion of a merger to address non-merger related environmental issues.[22] With such a clarification in the merger rules, the Board will advance its goal of increased reliance on negotiated solutions by keeping extraneous and unnecessarily contentious issues from interfering with the negotiation over merger-related effects.

AAR also understands the Board's concern about the need to monitor the implementation of a merger and, in appropriate situations, to address unforeseen merger-related environmental harms. See NOPR at 19 n.11. However, there should be limits on the Board's authority to revisit environmental issues in the oversight process and to impose new conditions where circumstances turn out differently from what the parties projected.[23] The Board should acknowledge, as it has done elsewhere, that it is impossible to predict with certainty future traffic flows or traffic levels and it should not hold the merger applicants to an unrealistic standard for predicting the future. As the Board recently found in the context of traffic flows, "while railroads do their best to predict the amount of post-transaction traffic likely to move over a

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[22] *See CSX/NS/Conrail* at 151-52.

[23] The Board's authority to address environmental issues is limited to its role in evaluating mergers under the public interest standard. The Board does not have independent regulatory authority in the environmental area.

given line, railroads need flexibility because the amount of traffic that actually moves over a particular line depends upon shipper demand."[24]

The Board should therefore make it clear that in determining whether a "material post-merger change" has occurred warranting possible conditions, it will recognize that railroad traffic patterns are dynamic and it will not impose new conditions in response to post-merger changes where those changes are consistent with natural fluctuations in railroad market conditions. Otherwise, the Board risks becoming bogged down in endless disputes.[25] In addition, without such limitations on the Board's future imposition of conditions, the merged carrier may be forced artificially to conform to operating conditions predicted at the time of the merger simply in order to avoid disputes, inhibiting its ability to conform to changing markets or operating conditions.

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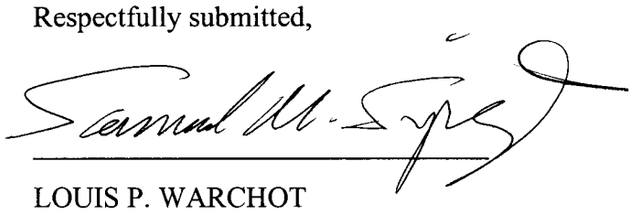
[24] *CSX/NS/Conrail*, Decision No. 96, slip op. at 22 (served Oct. 19, 1998).

[25] *See Friends of the River v. FERC*, 720 F.2d 93 (D.C. Cir. 1983) (reassessment of EIS by FERC not required in the face of new monthly forecasts and predictions since requiring such reassessments would immobilize the agency).

CONCLUSION

AAR requests that the Board modify its proposed merger rules consistent with the positions set forth in the foregoing comments.

Respectfully submitted,



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November 17, 2000

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was served on all Parties of Record by first class mail on November 17, 2000.

Anthony J. LaRocca